

GAO

United States General Accounting Office 130568  
Report to the Congress

July 1986

# FINANCIAL AUDIT

## Federal Deposit Insurance Corporation's Financial Statements for 1985 and 1984



036197

\_\_\_\_\_

\_\_\_\_\_

1

1

1

1

1

1

1

1

1

1

1

Comptroller General  
of the United States

B-114831

July 30, 1986

To the President of the Senate and the  
Speaker of the House of Representatives

This report presents our opinion on the Federal Deposit Insurance Corporation's financial statements for the years ended December 31, 1985 and 1984, and our reports on the Corporation's system of internal accounting controls and compliance with laws and regulations.

The Federal Deposit Insurance Corporation is an independent agency created by the Banking Act of 1933 to protect deposits in the nation's banks, help maintain confidence in the banking system, and promote safe and sound banking practices. We made our examinations pursuant to the provisions of 31 U.S.C. 9105 and in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Chairman of the Board of Directors, Federal Deposit Insurance Corporation.



Charles A. Bowsher  
Comptroller General  
of the United States

---

# Contents

---

Opinion Letter	4
----------------	---

---

Report on Internal Accounting Controls	6
---	---

---

Report on Compliance With Laws and Regulations	8
--	---

---

Financial Statements	10
Statements of Financial Position	10
Statements of Income and the Deposit Insurance Fund	12
Statements of Changes in Financial Position	13
Notes to Financial Statements	14



Comptroller General  
of the United States  
B-114831

To the Board of Directors  
Federal Deposit Insurance Corporation

We have examined the statements of financial position of the Federal Deposit Insurance Corporation as of December 31, 1985 and 1984, and the related statements of income and the deposit insurance fund, and of the changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Our opinion on the 1984 financial statements, dated May 3, 1985, was qualified as to the effects of the Corporation not establishing an allowance for loss related to the poor-quality loans and other assets acquired as part of an assistance program to Continental Illinois National Bank and Trust Company of Chicago. As a result of the Corporation's restatement of the 1984 financial statements (see note 2) to reflect an allowance for loss for this assistance and other related adjustments, our present opinion expressed on the 1984 financial statements is no longer qualified.

In our opinion, the financial statements referred to above present fairly the financial position of the Federal Deposit Insurance Corporation as of December 31, 1985 and 1984, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.



Charles A. Bowsher  
Comptroller General  
of the United States

June 16, 1986



# Report on Internal Accounting Controls

---

We have examined the Federal Deposit Insurance Corporation's financial statements for the years ended December 31, 1985 and 1984, and have issued our opinion thereon. As part of our examinations, we made a study and evaluation of the system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. This report pertains only to our study and evaluation of the system of internal accounting controls for the year ended December 31, 1985. (Our report on the study and evaluation of the system of internal accounting controls for the year ended December 31, 1984, is presented in GAO/AFMD-85-58, May 29, 1985.) For the purpose of this report, we have classified the significant internal accounting controls into the following categories:

- assessment cycle,
- assistance to problem banks cycle,
- expenditure cycle,
- financial reporting cycle, and
- treasury cycle.

Our study and evaluation was generally limited to a preliminary review of the system of internal accounting controls. The primary objectives of our study and evaluation were to obtain an understanding of the control environment and the flow of transactions through the accounting system and to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the Corporation's financial statements. Based on our preliminary review, we determined it was more efficient to expand substantive audit tests to verify account balances than to continue with a complete study and evaluation of internal accounting controls. However, we did evaluate the reliability of the controls over the assessment cycle and the payroll portion of the expenditure cycle. Therefore, with the exceptions noted, our study and evaluation of internal accounting controls did not extend beyond the preliminary review phase.

Corporation management is responsible for establishing and maintaining a system of internal accounting controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that (1) assets are safeguarded against loss from unauthorized use or disposition, and (2) transactions are executed in accordance with management's authorization and recorded properly to



---

permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any system of internal accounting controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation of internal accounting controls was made for the limited purpose described above. It was more limited than would be necessary to express an opinion on the system of internal accounting controls taken as a whole or on any of the categories of controls identified above, and it would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting controls of the Corporation taken as a whole or on any of the categories of controls we identified. However, our study and evaluation of internal accounting controls disclosed no condition that we believe to be a material weakness that would affect our opinion on the financial statements. During the course of our examination, we did identify a number of opportunities for improving internal controls and procedures. We are communicating our findings to the Corporation through a separate management letter.

---

# Report on Compliance With Laws and Regulations

---

We have examined the Federal Deposit Insurance Corporation's financial statements for the years ended December 31, 1985 and 1984, and have issued our opinion thereon. Our examinations were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures, including tests of compliance with laws and regulations, as we considered necessary in the circumstances. This report pertains only to our review of compliance with laws and regulations for the year ended December 31, 1985. (Our report on compliance with laws and regulations for the year ended December 31, 1984, is presented in GAO/AFMD-85-58, May 29, 1985.)

In our opinion, the Corporation complied with the terms and provisions of laws and regulations for the transactions tested that could have materially affected its financial statements.

Nothing came to our attention in connection with our examination that caused us to believe that the Corporation was not in compliance with the terms and provisions of laws and regulations for those transactions not tested.



# Financial Statements

## Statements of Financial Position (In Thousands)

	<u>1985</u>	<u>December 31</u>	<u>1984 (2)</u>
ASSETS:			
CASH	\$ 23,186		\$ 4,158
INVESTMENT IN U.S. TREASURY OBLIGATIONS (Note 3)	15,841,869		14,436,286
OTHER ASSETS, principally accrued interest receivable on investments	499,229		393,944
CERTIFICATES, NOTES AND OTHER RECEIVABLES FROM INSURED BANKS (Note 4)	590,254		560,883
ASSETS ACQUIRED IN ASSISTANCE TO AN INSURED BANK (Note 5)	2,712,842		3,757,429
ASSETS ACQUIRED FROM FAILURES OF INSURED BANKS (Note 6)	2,358,554		2,143,540
PROPERTY AND BUILDINGS (Note 7)	<u>47,164</u>		<u>41,701</u>
TOTAL ASSETS	<u>\$22,073,098</u>		<u>\$21,337,941</u>

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

	<u>1985</u>	<u>December 31</u>	<u>1984 (2)</u>
LIABILITIES AND THE DEPOSIT INSURANCE FUND.			
ACCOUNTS PAYABLE, ACCRUED LIABILITIES AND ESCROW FUNDS	\$ 80,649		\$ 100,479
NET ASSESSMENT INCOME CREDITS DUE TO INSURED BANKS: (Note 8)			
Available July 1, 1986	-0-		-0-
Available July 1, 1985	-0-		-0-
LIABILITIES INCURRED IN ASSISTANCE TO INSURED BANKS (Note 9)	3,442,752		3,848,342
LIABILITIES INCURRED FROM FAILURES OF INSURED BANKS (Note 10)	578,367		859,641
ESTIMATED LOSSES FROM CORPORATION LITIGATION (Note 11)	<u>14,340</u>		<u>-0-</u>
TOTAL LIABILITIES	4,116,108		4,808,462
DEPOSIT INSURANCE FUND	<u>17,956,990</u>		<u>16,529,479</u>
TOTAL LIABILITIES AND THE DEPOSIT INSURANCE FUND	<u>\$22,073,098</u>		<u>\$21,337,941</u>

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

## Statements of Income and the Deposit Insurance Fund (In Thousands)

	For the year ended December 31	
	1985	1984 (2)
<b>INCOME:</b>		
Gross assessments earned	\$ 1,434,578	\$ 1,322,587
Provision for assessment credits	<u>1,081</u>	<u>1,000</u>
Net assessments earned	1,433,497	1,321,587
Interest on U.S. Treasury obligations	1,599,745	1,495,377
Interest on notes receivable	37,531	111,730
Interest on assets in liquidation	282,012	168,580
Other income	<u>32,660</u>	<u>2,243</u>
TOTAL INCOME	<u>3,385,445</u>	<u>3,099,517</u>
<b>EXPENSES AND LOSSES:</b>		
Administrative operating expenses	179,209	151,201
Merger assistance losses and expenses	199,377	197,559
Provision for insurance losses (Notes 4,5,6 and 12)	1,568,992	1,633,374
Nonrecoverable insurance expenses (Note 13)	<u>10,356</u>	<u>17,084</u>
TOTAL EXPENSES AND LOSSES	<u>1,957,934</u>	<u>1,999,218</u>
NET INCOME	1,427,511	1,100,299
DEPOSIT INSURANCE FUND - January 1	<u>16,529,479</u>	<u>15,429,180</u>
DEPOSIT INSURANCE FUND - December 31	<u>\$17,956,990</u>	<u>\$16,529,479</u>

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

# Financial Statements

## Statements of Changes in Financial Position (In Thousands)

	For the year ended December 31	
	1985	1984 (2)
FINANCIAL RESOURCES WERE PROVIDED FROM		
Operations		
Net Income	\$1,427,511	\$ 1,100,299
Add (deduct) items not involving cash in the period		
Amortization of U S Treasury obligations	57,575	18,104
Loss on sale of U S Treasury obligations	-0-	982
Depreciation on buildings	1,115	977
Income maintenance agreement adjustments	(109,517)	80,753
Amortization of merger assistance agreements	39,128	40,131
Provision for insurance losses	<u>1,568,992</u>	<u>1,633,374</u>
Resources provided from operations	2,984,804	2,874,620
Other resources provided from		
Maturity and sale of U.S Treasury obligations	3,798,500	3,755,184
Collections on notes receivable	259,641	2,528,119
Collections on assets acquired in assistance to an insured bank	549,295	-0-
Collections on assets acquired from failures of insured banks	924,353	1,701,734
Liabilities incurred in assistance to insured banks	128,027	3,848,342
Liabilities incurred from failures of insured banks	<u>91,999</u>	<u>-0-</u>
TOTAL FINANCIAL RESOURCES PROVIDED	<u>\$8,736,619</u>	<u>\$14,707,999</u>
FINANCIAL RESOURCES WERE APPLIED TO		
Purchase of U S Treasury obligations	\$5,261,658	\$ 4,218,497
Acquisition of notes receivable	251,527	2,848,342
Assets acquired in assistance to an insured bank	146,708	4,457,429
Assets acquired from failures of insured banks	2,089,501	2,603,638
Additions to property and buildings	6,578	5,709
Decrease (increase) in net assessment income credits due to insured banks	-0-	164,039
Payments on liabilities incurred in assistance to insured banks	533,617	-0-
Payments on liabilities incurred in failures of insured banks	302,884	515,006
Increase (decrease) in cash	19,028	(84,627)
Other increases (decreases)	<u>125,118</u>	<u>(20,034)</u>
TOTAL FINANCIAL RESOURCES APPLIED	<u>\$8,736,619</u>	<u>\$14,707,999</u>

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements

## Notes to Financial Statements

DECEMBER 31, 1985 AND 1984

1 Summary of Significant Accounting Policies

General These statements do not include accountability for assets and liabilities of closed insured banks for which the Corporation acts as receiver or liquidating agent. Periodic and final accountability reports of its activities as receiver or liquidating agent are furnished by the Corporation to courts, supervisory authorities, and others as required.

U.S. Treasury Obligations Securities are shown at amortized cost which is the purchase price of securities less the amortized premium or plus the accreted discount. Such amortizations and accretions are computed on a daily basis from the date of acquisition to the date of maturity. Interest is also calculated on a daily basis and recorded monthly. For the year ended December 31, 1984, the Corporation changed from the straight-line method to the constant-yield method. This change did not have a material effect on net income.

Deposit Insurance Assessments The Corporation assesses insured banks at the rate of 1/12 of one percent per year on the bank's average deposit liability less certain exclusions and deductions. Assessments are due in advance for each six-month period and credited to income each month. The Depository Institutions Deregulation and Monetary Control Act of 1980 authorized a percentage of net assessment income to be transferred to insured banks each July 1 of the following calendar year to 60 percent. Additionally, the Act authorized the FDIC Board of Directors to make adjustments to this percentage within certain limits in order to maintain the Deposit Insurance Fund between 1.25 and 1.40 percent of estimated insured deposits. If this ratio falls below 1.10 percent, the FDIC is mandated to reduce the percentage of net assessment income distributed to a limit of 50 percent. If this ratio exceeds 1.40 percent, the FDIC is mandated to increase the percentage of net assessment income distributed by such an amount as it determines will result in maintaining that ratio at not more than 1.40 percent.

Assistance to and Assets Acquired from Insured Banks and the Related Allowance for Losses

The Corporation records as an asset the funds advanced in assisting insured banks and the assets purchased in closing failed banks. The Corporation establishes an estimated allowance for loss shortly after the assistance is provided or the assets are purchased. The allowance for loss represents the difference between the assistance provided and the expected amount of repayment, or the purchase price of the assets of a failed bank less the estimated recovery value, including all liquidation costs. The allowance for loss on the financial statements includes all insured banks which have been assisted or have failed. However, the Corporation has not estimated its contingent liability for those banks financially distressed as of December 31, 1985, which will probably require assistance or closing in the near term. The Corporation's entire Deposit Insurance Fund and borrowing authority are available for any assistance or closing activity.

Income Maintenance Agreements The Corporation records its liability under an income maintenance agreement at the present value of each estimated cash outlay at the time the agreement is accepted. Estimated cash outlays are anticipated future payments the Corporation will provide to offset the difference between the annualized cost of funds and the annualized return on the declining volume of earning assets acquired in a merger transaction plus an amount to cover overhead costs. The charge is recorded to insurance loss. The present value of the liability is then accreted daily and recorded monthly over the term of the agreement. Any differences between the estimated and actual cash outlays are recorded as payment adjustments. The present value of remaining estimated cash outlays is



Income Maintenance Agreements (Continued)

also reviewed and adjusted each year when interest rate changes occurring in the marketplace appear material or permanent in nature. The originally recorded loss, plus or minus any payment and present value adjustments, will then be prorated between insured banks and the Deposit Insurance Fund as provided in Section 7(d) of the Federal Deposit Insurance Act.

Reclassifications Reclassifications have been made in the 1984 Financial Statements to conform to the presentation used in 1985. In addition, as explained in Note 2, the Corporation has restated its 1984 financial statements to include an additional allowance for loss of \$700 million related to the 1984 Continental Illinois National Bank and Trust Company of Chicago (CINB) transaction.

2 Calendar Year 1984 Restatement

For 1984, the Corporation did not estimate the amount of loss it expected to incur from the assistance program for Continental Illinois National Bank and Trust Company of Chicago (CINB) as required by generally accepted accounting principals. (See Note 5.) Consequently, the loss allowance in the 1984 financial statements was materially understated.

As of December 31, 1985, the Corporation's estimated allowance for losses from assistance to open and closed banks amounted to \$4,510,692,000. Of that amount, \$700,000,000 was determined to be applicable to 1984 financial transactions related to the acquisition of assets from CINB in 1984. Accordingly, the Corporation has restated its December 31, 1984 financial statements to reflect this adjustment. The following table shows the results of the restatement for the affected line items (in thousands):

<u>Statement Line Item</u>	<u>Original 1984 Amount</u>	<u>Change Add (Deduct)</u>	<u>Restated 1984 Amount</u>
Assets Acquired in Assistance to an Insured Bank	\$ 4,457,429	\$(700,000)	\$ 3,757,429
Total Assets	\$22,037,941	\$(700,000)	\$21,337,941
Total Liabilities	\$ 4,876,009	\$ (67,547)	\$ 4,808,462
Total Liabilities and the Deposit Insurance Fund	\$22,037,941	\$(700,000)	\$21,337,941
Net Assessment Income	\$ 1,254,039	\$ 67,548	\$ 1,321,587
Net Income	\$ 1,732,752	\$(632,453)	\$ 1,100,299
Deposit Insurance Fund	\$17,161,932	\$(632,453)	\$16,529,479

As a result of restating the 1984 loss allowance to include CINB, the 1984 assessment credit was eliminated. As provided by statute, an excess of deductions (expenses) above the assessment income of \$599,601 was created. This excess will be offset against future assessment credits that may be granted by the Corporation.

3 U S Treasury Obligations

All cash received by the Corporation which is not used to defray operating expenses or for outlays related to assistance to banks and liquidation activities is invested in U S Treasury securities. The Corporation's investment portfolio consist of the following (in thousands).

Maturity	Description	December 31, 1985		December 31, 1984	
		Book Value	Market Value	Book Value	Market Value
One Day	Special Treasury Certificates	\$ 1,682,000	\$ 1,682,000	\$ 759,127	\$ 759,127
Less Than 1 year	U.S T. Bills, Notes and Bonds	3,215,419	3,253,159	2,209,252	2,226,362
1-3 years	U.S.T. Notes and Bonds	6,738,907	7,045,385	6,186,261	6,239,531
3-5 years	U S T Notes and Bonds	<u>4,205,543</u>	<u>4,473,698</u>	<u>5,281,646</u>	<u>5,216,021</u>
		<u>\$15,841,869</u>	<u>\$16,454,242</u>	<u>\$14,436,286</u>	<u>\$14,441,041</u>

4 Certificates, Notes and Other Receivables from Insured Banks.

The Corporation's outstanding principal balances on certificates, notes and other receivables from insured banks are as follows (in thousands).

	December 31	
	1985	1984
<u>Certificates</u>		
Net worth certificates	\$219,847	\$348,342
Allowance for losses	(136,996)	(182,981)
	<u>82,851</u>	<u>165,361</u>
<u>Notes receivable to</u>		
Assist operating banks	27,000	27,000
Facilitate deposit assumptions	90,755	93,374
Facilitate merger agreements	<u>389,648</u>	<u>275,148</u>
	<u>507,403</u>	<u>395,522</u>
<u>Other receivables</u>		
Special assistance	8,500	-0-
Allowance for losses	(8,500)	-0-
	<u>-0-</u>	<u>-0-</u>
	<u>\$590,254</u>	<u>\$560,883</u>

4 Certificates, Notes and Other Receivables from Insured Banks (Continued)

The net worth certificate program was established at the FDIC by authorization of the Garn-St Germain Depository Institutions Act of 1982. Under this program, the Corporation would purchase a qualified institution's net worth certificate and, in a non-cash exchange, the Corporation would issue its non-negotiable promissory note of equal value. The total assistance outstanding to qualified institutions as of December 31, 1985 and 1984 is \$700,318,000 and \$578,791,000 respectively. As of December 31, 1985 and 1984, the financial statements excluded \$480,471,000 and \$230,449,000 respectively of net worth certificates, for which no losses are expected because of the non-cash exchange nature of the transactions.

5 Assets Acquired in Assistance to an Insured Bank

On July 26, 1984, the FDIC, the Federal Reserve Board, the Comptroller of the Currency and a group of major U.S. banks agreed to provide a "permanent assistance program" to the Continental Illinois National Bank and Trust Company of Chicago ("CINB") and its parent, Continental Illinois Corporation. This program, which became effective on September 26, 1984, after Continental Illinois Corporation shareholder approval, replaced a temporary emergency assistance package among the same parties that had been in effect since May 1984. Major elements of the new package included a financial assistance plan to remove problem loans from CINB and infuse new capital resources into CINB, the continuation of on-going lines of credit from the Federal Reserve Board and a group of major U.S. banks to alleviate liquidity pressures and the installation of a new management team. Additionally, the FDIC agreed to commit more capital or other forms of assistance if the permanent assistance program proves to be insufficient for any reason.

The key aspects of the permanent assistance program applicable to the FDIC are embodied in an Implementation Agreement and an Assistance Agreement between the FDIC and CINB, Continental Illinois Corporation, and Continental Illinois Holding Corporation, a new holding company formed to own all Continental Illinois Corporation stock as of the effective date for the purpose of implementing the FDIC Option. Discussed below are the major aspects of the FDIC's participation in the permanent assistance program and their effect on the FDIC financial statements.

The assets acquired by the FDIC in assistance to CINB are as follows (in thousands):

	<u>December 31</u>	
	<u>1985</u>	<u>1984</u>
Loans and related assets purchased	\$2,126,894	\$2,010,313
Promissory note	927,948	1,447,116
Preferred stock investment	1,000,000	1,000,000
Allowance for losses	(1,342,000)	(700,000)
	<u>\$2,712,842</u>	<u>\$3,757,429</u>

Loans acquired were selected by CINB with the restrictions that such loans were nonperforming, classified or otherwise of poor quality (i.e., "troubled loans"). Certain foreign loans were excluded from selection. On September 26, 1984, after consummation of the permanent assistance program, CINB transferred \$2.0 billion of troubled loans to the FDIC. The unpaid legal principal value of these loans was approximately \$3.7 billion.

5 Assets Acquired in Assistance to an Insured Bank (Continued).

Also, on September 26, 1984, the FDIC received a promissory note from CINB for \$1.5 billion. At CINB's option, the promissory note can be paid anytime within three years by transfer of additional troubled loans (subject to the above restrictions) at CINB's book value as of the date of transfer. Until such time as the promissory note is paid, interest will be charged. As of December 31, 1985, CINB transferred \$519,168,000 of additional troubled loans to the FDIC as partial repayment on the original promissory note. As a result, the remaining unpaid principal balance on the note is \$927,948,000.

The purchase of these assets was, in part, funded by the assumption of \$3.5 billion of indebtedness to the Federal Reserve Bank of Chicago (FRB) on behalf of CINB. These borrowings will bear interest at specified rates established by the FRB and the U.S. Treasury. The FDIC will repay these borrowings by making quarterly remittances of its collections, less expenses, on the troubled loans. If there is a shortfall at September 26, 1989, the FDIC will make up such deficiency with its own funds.

The Implementation Agreement provides for the FDIC to be reimbursed each quarter for its expenses related to administering the transferred loan portfolio and for interest paid on the indebtedness to the FRB which it assumed. Thus, such costs are recorded as assets. The FDIC and CINB have entered into a service agreement whereby CINB will administer the transferred loan portfolio on behalf of the FDIC. The FDIC is also permitted to establish a special reserve account from troubled loan collections. The balance in this account, if any, reverts to the FDIC in those quarters when loan collections have been insufficient to cover interest owing on the indebtedness which it assumed. For financial accounting purposes, cash collections received on the transferred loan portfolio (plus certain other amounts) are applied quarterly in accordance with the Implementation Agreement terms, as follows: 1) to the administrative expenses paid by the FDIC; 2) to the interest owing on the assumed indebtedness; 3) to fund the special reserve account such that this account plus accrued interest thereon is at least \$75 million; and 4) to principal owing under the FRB Agreement. The FDIC is entitled to receive interest on the cumulative deficiencies between cash collections and the costs incurred in administering the troubled loans and the interest on the assumed debt. Further, CINB has assigned to the FDIC all its existing and future claims against any party which may be related to any loss incurred in connection with any transferred loan.

Total cash flow consists of the above collections of principal and interest on the transferred loan portfolio, interest payments on the CINB promissory note and interest earned on daily collections. For the year ending December 31, 1985, the FDIC received net cash flow totaling \$700,800,000. Cash flow was applied to administrative costs and to interest expense of \$19,286,000 and \$281,887,000, respectively, to the special reserve account \$24,726,000 and to payment of principal owing under the FDIC-FRB agreement amounting to \$374,901,000.

Ultimate collection results on the transferred loan portfolio are subject to significant uncertainties because of the financially troubled nature of the borrowers and the effects of general economic conditions on their industries. As of December 31, 1985, the Corporation estimated an allowance for loss amounting to \$1,342,000,000. This amount represents the expected loss that the Corporation will sustain on the transferred loan portfolio.

The FDIC holds an option to acquire up to 40.3 million shares of Continental Illinois Corporation common stock. The shares subject to the option are owned by Continental Illinois Holding Corporation, which is owned by the former stockholders of Continental Illinois Corporation. The option cannot be exercised prior to the fifth anniversary of the commencement date, September 26, 1989. Further, the option is exercisable only if the FDIC suffers a loss (disregarding any profit or loss from the FDIC's interest in Continental Illinois Corporation preferred or common stock) on the transferred loan portfolio, including

5 Assets Acquired in Assistance to an Insured Bank (Continued).

unrecovered administrative costs and interest expense. If the FDIC suffers a loss, the FDIC will be entitled to retain any remaining transferred loans and to exercise the FDIC Option for one share of Continental Illinois Corporation common stock for every \$20 of loss, at the exercise price of \$0.00001 per share of common stock. Because of uncertainty, no value has been assigned to the FDIC's right to exercise this option as of December 31, 1985. If the FDIC does not suffer any loss under the permanent assistance program, all remaining loans and other assets acquired will be returned to CINB and the option would not be exercisable.

The FDIC also purchased \$1 billion of two non-voting, Continental Illinois Corporation, preferred stock issues. The proceeds of these issues were transferred to CINB in the form of a capital contribution. The Junior Perpetual Convertible Preference Stock, in the amount of \$720 million, is convertible into 160 million shares of Continental Illinois Corporation common stock upon sale or transfer by the FDIC. Dividends are to be received on this preferred stock only to the extent that dividends are paid on the Continental Illinois Corporation common stock and are equivalent to that which would be paid on 160 million shares of common stock. The Adjustable Rate Preferred Stock, Class A, in the amount of \$280 million, is a cumulative issue that is callable at the option of Continental Illinois Corporation. The issuer also has the option to pay dividends on this issue in the form of additional shares of this issue or cash until the third anniversary of their original issue date. On December 31, 1985, the Corporation received 1,637,922 additional shares of Adjustable Rate Preferred Stock, Class A in payment of stock dividends on the Class A stock for the initial and quarterly dividend periods from September 26, 1984 through September 30, 1985 and the quarterly dividend period from October 1, 1985 through December 31, 1985.

6. Assets Acquired from Failures of Insured Banks:

Assets acquired from failures of insured banks are as follows (in thousands):

	<u>December 31</u>	
	<u>1985</u>	<u>1984</u>
Depositors' claims paid	\$1,069,553	\$ 731,288
Depositors' claims unpaid	11,136	6,815
Loans and assets purchased in a fiduciary capacity	3,836,002	3,088,354
Assets purchased in a corporate capacity	<u>450,719</u>	<u>377,219</u>
	5,367,410	4,203,676
Allowance for losses	<u>(3,008,856)</u>	<u>(2,060,136)</u>
	<u>\$2,358,554</u>	<u>\$2,143,540</u>

6 Assets Acquired from Failures of Insured Banks (Continued)

An analysis of the changes in the allowance for losses by account groups is as follows (in thousands)

	Depositor's claims paid	Loans and assets purchased in a		
		Fiduciary capacity	Corporate capacity	Total
<u>1985</u>				
Balance, January 1	\$158,057	\$1,537,398	\$364,681	\$2,060,136
Provision for insurance losses	307,830	617,213	24,185	949,228
Write-off at termination	-0-	(508)	-0-	(508)
Balance, December 31	<u>\$465,887</u>	<u>\$2,154,103</u>	<u>\$388,866</u>	<u>\$3,008,856</u>
<u>1984</u>				
Balance, January 1	\$175,832	\$ 727,362	\$406,549	\$1,309,743
Provision for insurance losses	(17,775)	810,036	(41,868)	750,393
Write-off at termination	-0-	-0-	-0-	-0-
Balance, December 31	<u>\$158,057</u>	<u>\$1,537,398</u>	<u>\$364,681</u>	<u>\$2,060,136</u>

7 Property and Buildings

Property and buildings consist of (in thousands)

	1985	December 31	1984
Land	\$ 4,014		\$ 4,014
Office buildings	49,603		43,025
Accumulated depreciation	(6,453)		(5,338)
	<u>\$47,164</u>		<u>\$41,701</u>

The Corporation's 1776 F Street property is subject to notes payable totaling \$9,491,000 and \$10,926,000 at December 31, 1985 and 1984, respectively

8 Assessment Credits Due Insured Banks

Contingent upon a legislatively specified ratio of the Corporation's Deposit Insurance Fund to estimated insured bank deposits, the Corporation credits a legislatively authorized percentage (currently 60 percent) of its net assessment income to insured banks. This credit is distributed, pro-rata, to each insured bank as a reduction of the following year's assessment. Net assessment income is determined by gross assessments less administrative operating expenses and expenses and losses related to insurance operations. Certain income, expense, and credit amounts do not correspond to amounts reported on the financial statements because of adjustments to prior years' assessment credits not affecting the 1985 and 1984 assessment credit computational amounts.

The Garn-St Germain Depository Institutions Act of 1982 amended Section 7(d)(1) of the Federal Deposit Insurance Act and authorized the Corporation to include certain lending costs

8 Assessment Credits Due Insured Banks (Continued)

In the computation of the net assessment income The lending costs are the amounts by which the amount of interest earned on each loan made by the Corporation under Section 13 of the Federal Deposit Insurance Act after January 1, 1982, is less than the amount of interest the Corporation would have earned for the calendar year if interest had been paid on the loans at a rate equal to the average current value of funds to the U.S. Treasury for the calendar year

The computation of net assessment income credits for calendar year 1985 and 1984 are as follows (in thousands)

Net Assessment Income Credit Computation - Calendar Year 1985

Computation		
Gross assessment income-C Y. 1985		\$1,432,381
Less Carry-over of net expenses and losses from C Y. 1984	\$599,601	
Administrative operating expenses	179,209	
Merger assistance losses and expenses less amortization and accretion.	194,700	
Provision for insurance losses related to assets acquired in assistance to an insured bank	642,000	
Provision for insurance losses	926,385	
Nonrecoverable insurance expenses	4,956	
Lending costs	145	2,546,996
Excess of losses and expenses over gross assessment income		1,114,615
Less Assessment credit adjustment - prior years		661
Net excess of losses and expenses over gross assessment income-C Y. 1985		<u>\$1,113,954</u>

Net Assessment Income Credit Computation - Calendar Year 1984

Computation		
Gross assessments income - C Y. 1984		\$1,319,170
Less Administrative operating expenses	\$151,201	
Merger assistance losses and expenses less amortization and accretion	135,383	
Provision for insurance losses related to assets acquired in assistance to an insured bank	700,000	
Provision for insurance losses	933,374	
Nonrecoverable insurance expenses	17,084	1,937,042
Excess of losses and expenses over gross assessment income		617,872
Less Assessment credit adjustment - prior years		18,271
Carry-over of net expenses and losses to be applied against 1985 gross assessments		<u>\$ 599,601</u>

9 Liabilities Incurred in Assistance to Insured Banks

The Corporation's outstanding principal balances on liabilities incurred in assistance to insured banks are as follows (in thousands).

	<u>December 31</u>	
	<u>1985</u>	<u>1984</u>
Federal indebtedness	\$3,222,905	\$3,500,000
Promissory (exchange) notes	<u>219,847</u>	<u>348,342</u>
	<u>\$3,442,752</u>	<u>\$3,848,342</u>

Maturities of long-term debt for each of the next five years and thereafter

<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991/Thereafter</u>
\$ -0-	\$ -0-	\$ -0-	\$3,284,509	\$56,655	\$101,588

10 Liabilities Incurred from Failures of Insured Banks

The Corporation's outstanding principal balances on liabilities incurred from failures of insured banks are as follows (in thousands)

	<u>December 31</u>	
	<u>1985</u>	<u>1984</u>
Federal indebtedness	\$306,083	\$442,667
Notes payable	157,196	222,813
Income maintenance agreements	103,952	187,346
Depositor's claims unpaid	<u>11,136</u>	<u>6,815</u>
	<u>\$578,367</u>	<u>\$859,641</u>

Maturities of long-term debt for each of the next five years and thereafter

<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991/Thereafter</u>
\$345,591	\$39,125	\$20,691	\$19,355	\$22,960	\$119,509

Depositor's claims unpaid (\$11,136) are current in nature and are not considered long-term debt

11 Estimated Losses From Corporation Litigation

The Corporation is involved in both its receivership and corporate capacity in numerous law suits. The merits of each case and the expected outcome has been evaluated by the Corporation's General Counsel, and, where appropriate, a contingent loss has been established. This estimated loss was \$228 million in 1985. Of that amount, a \$214 million legal reserve was included in the reserve relating to assets acquired from assistance to a insured bank and from failed banks. The remaining \$14 million is included on the financial statements as estimated losses from corporation litigation.



12 Provision for Insurance Losses

An analysis of the provision for insurance losses is as follows (in thousands)

	<u>December 31</u>	
	<u>1985</u>	<u>1984</u>
Provision for insurance losses		
Net worth certificates		
Current year provision	\$ -0-	\$ 182,981
Prior year adjustments	(45,985)	-0-
	<u>(45,985)</u>	<u>182,981</u>
Special assistance		
Current year provision	<u>8,500</u>	<u>-0-</u>
Assets acquired from assistance to an insured bank		
Current year provision	<u>642,000</u>	<u>700,000</u>
Assets acquired from failures of insured banks		
Current year provision	433,394	283,219
Prior year adjustments	515,834	467,174
Termination adjustments	909	-0-
	<u>950,137</u>	<u>750,393</u>
Corporation litigations		
Current year provision	<u>14,340</u>	<u>-0-</u>
	<u>\$1,568,992</u>	<u>\$1,633,374</u>

13 Nonrecoverable Insurance Expenses

The Corporation's nonrecoverable insurance expenses primarily represent costs associated with (1) preparing and executing the activity in payoff cases and (2) administering and liquidating the assets purchased in a corporate capacity. As of December 31, 1985 and 1984, nonrecoverable insurance expenses included \$-0- and \$13,136,000 respectively, of interest expense incurred on the Federal Reserve Bank of New York indebtedness related to the administering and liquidating of assets purchased in a corporate capacity.

14 Lease Commitments

Rent for office premises charged to administrative operating and liquidation overhead expenses were \$22,605,000 (1985) and \$11,947,000 (1984). Minimum rentals for each of the next five years and for subsequent years thereafter are as follows (in thousands):

<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991/Thereafter</u>
\$20,587	\$15,670	\$12,649	\$9,222	\$8,165	\$15,770

Most office premise lease agreements provide for increase in basic rentals resulting from increased property taxes and maintenance expense.

15 Pension Plan and Accrued Annual Leave.

All of the Corporation's permanent employees are covered by the Civil Service Retirement System. Total Corporation (employer) matching contributions to the Civil Service Retirement System for all permanent employees were approximately \$8,356,000 and \$7,634,000 for the calendar years ending December 31, 1985 and 1984, respectively.

Although the Corporation funds a portion of pension benefits under the Civil Service Retirement System relating to its permanent employees and makes the necessary payroll withholdings from them, the Corporation does not account for the assets of the Civil Service Retirement System nor does it have actuarial data with respect to accumulated plan benefits or the unfunded liability relative to its permanent employees. These amounts are reported by the Office of Personnel Management for the Retirement System and are not allocated to the individual employers.

The Corporation's liability to employees for accrued annual leave is approximately \$8,571,000 and \$8,104,000 at December 31, 1985 and 1984, respectively.

16 Subsequent Events

Subsequent to the calculation of the allowance for losses, the economy experienced some significant events -- falling oil prices, further declines in the farm sector, deterioration of foreign loans and lowered interest rates, to name a few. These events may cause major changes in the valuation of the assets acquired in assistance to troubled and failed banks, and consequently in the Corporation's allowance for losses.

The decline in oil prices has impaired the value of some of the more than \$2 billion in energy-related assets held by the FDIC as a result of transactions with troubled and failed banks. The decline may also result in an increase in the number of banks that will require future assistance (see Note 1 to the financial statements, Assistance To and Assets Acquired from Insured Banks and the Related Allowance for Losses). The impact of the oil price decline has not been reflected in the financial statements, as the price decline occurred after December 31, 1985.

17 Commitments and Contingencies

The Corporation insures total deposits of about \$1.5 trillion in over 14,000 insured commercial banks. The Corporation does not estimate its contingent liability for either the potential assistance to insured banks that the regulatory process has identified as distressed or other insured banks that are financially weak but have not yet been identified by the regulatory process. As of the December 31, 1985, the Corporation believed it impractical to calculate such an estimate with reasonable certainty. The Corporation, along with the U.S. General Accounting Office, our independent auditor, is continuing to examine this issue.

---

Requests for copies of GAO reports should be sent to:

U.S. General Accounting Office  
Post Office Box 6015  
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each report are free. Additional copies are \$2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.

---

United States  
General Accounting Office  
Washington, D.C. 20548

Official Business  
Penalty for Private Use \$300

Address Correction Requested

---

First-Class Mail Postage & Fees Paid GAO Permit No. G100
---